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Letter Ruling 06-2: MHRTC & IRC 501(c)(3) Organizations

March 8, 2006

You request a letter ruling on behalf of ***** Partnership and one of its limited partners, Limited Partner, ***** an Internal Revenue Code ("IRC") § 501(c)(3) organization. You ask for confirmation that:

- (1) the Partnership cannot transfer the Massachusetts historic rehabilitation tax credit ("MHRTC") pursuant to G.L. c. 62, § 6J(b)(2)(ii); it may only pass it through to its partners who may then transfer it pursuant to § 6J(b)(2)(ii) or G.L. c. 63, § 38R(b)(2)(ii), whichever applies;
- (2) the Partnership may allocate 100% of the MHRTC to Limited Partner even though Limited Partner is entitled to only .01% of all profits; and
- (3) Limited Partner, an IRC § 501(c)(3) organization, may transfer the MHRTC pursuant to G.L. c. 63, § 38R(b)(2)(ii).

Facts

The Partnership is a Massachusetts limited partnership. It has two limited partners, one of which is Limited Partner, a Massachusetts non-profit corporation established under c. 180 of the Massachusetts General Laws, classified federally as an IRC § 501(c)(3) organization. The general partner is ***** , a Massachusetts corporation which is a wholly-owned subsidiary of Limited Partner.

Prior to January 21, 2005, as part of its stated mission to address the economic and community development needs of low income families and individuals, Limited Partner through the Partnership undertook the rehabilitation work of 64 residential units and a small amount of commercial space in an existing building located in ***** Massachusetts. Limited Partner formed the Partnership to own the building and to oversee the rehabilitation work. Pursuant to an Agreement of Limited Partnership, Limited Partner is entitled to .01% of all profits, losses, deductions, and gains of the Partnership and 100% of the MHRTC. Limited Partner does not have any unrelated business taxable income as defined in IRC § 512. The MHRTC is not derived from activities unrelated to Limited Partner's charitable purposes.

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On January 21, 2005, the Partnership received a letter from the Massachusetts Historical Commission (“MHC”) informing it that the ***** project had been selected to receive \$500,000 of MHRTC funds and that additional funds may be applied for in the future, not to exceed a total of 20% of the qualified rehabilitation costs for the project. Additionally, the letter stated that the \$500,000 allocation was contingent upon the successful completion of the project and the approval of part three of the MHRTC application in accordance with the Massachusetts Historic Rehabilitation Tax Credit Regulation, 830 CMR 63.38R.1.

The rehabilitation work was completed and the property was placed in service in 2005. On February 27, 2006, the Partnership received a final certification regarding the property from the MHC.

Discussion

Ruling 1: Transfer or Pass Through. Under the Massachusetts General Laws, it is the partners, not the partnership, that are subject to tax on their distributive share of partnership taxable income. G.L. c. 62, § 17. While the partnership pays no taxes, it is required under § 17 to report the income it generates and provide the information necessary for reporting by the partners on their individual returns. The character of any item of income, loss, deduction, or credit to be included by a partner on its return of income is to be determined as if such item were realized directly by the partner from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership. G.L. c. 62, § 17(c).

In allowing a MHRTC against partnership income, G.L. c 62, § 6J(b)(2)(i) provides, consistent with the above statutory scheme^[1] that the:

[h]istoric rehabilitation tax credits allowed to a partnership, a limited liability company taxed as a partnership or multiple owners of property shall be passed through to the persons designated as partners, members or owners, respectively. . . .

See also 830 CMR 63.38R.1(8), *The Massachusetts Historic Rehabilitation Tax Credit Regulation* (“Regulation”). The MHRTC is passed through to the partners, members, or owners as it is they, not the partnership, that must include the partnership’s items of income, loss, deduction, or credit on their returns of income, determined as if such items were realized directly by them from the sources from which realized by the partnership. Thus, it is they, not the partnership, that are the “taxpayer” eligible to transfer the MHRTC pursuant to G.L. c. 62, § 6J(b)(2)(ii) or G.L. c. 63, § 38R(b)(2)(ii).

Under G.L. c. 62, § 6J(b)(2)(ii) it is provided in relevant part that:

[t]axpayers eligible for the [MHRTC] may, with prior notice to and in accordance with regulations adopted by the commissioner, transfer the credits, in whole or in part, to any individual or entity, and the transferee shall be entitled to apply the credits against the tax with the same effect as if the transferee had incurred the qualified rehabilitation expenditures itself. . . .

G.L. c. 63, § 38R(b)(2)(ii) is worded identically, except that wherever the term “tax” is used in the above-quoted language, § 38R(b)(2)(ii) uses the term “excise.” See also 830 CMR 63.38R.1(7).

While “taxpayer,” as that term is used in G.L. c. 62, § 6J(b)(2)(ii), is defined as “a person, firm, partnership, trust, estate, limited liability company or other entity subject to the income tax imposed by the provisions of [c. 62]” (G.L. c. 62, § 6J(a)), it is clear when considering all of the statutory provisions discussed above as a consistent whole, as a well-established rule of statutory construction compels us to do, that the c. 62 “taxpayer” eligible to transfer the MHRTC is the partner,

member, or owner, not the partnership, as it is the former, not the latter, that is "subject to the income tax imposed by the provisions of . . . [c. 62]."

Ruling 2: 100% Allocation of the MHRTC. Pursuant to G.L. c 62, § 6J(b)(2)(i) it is provided that the MHRTC allowed to a partnership:

shall be passed through to the persons designated as partners, members or owners, respectively, pro rata or pursuant to an executed agreement among the persons designated as partners, member or owners documenting an alternative distribution method without regard to their sharing of other tax or economic attributes of the entity.

See *also* 830 CMR 63.38R.1(8). Thus, while the credit must be distributed pro rata among the various partners, members, or owners absent a partnership agreement stating otherwise, it may be allocated to any one or more of them without regard to their sharing of other tax or economic attributes of the partnership pursuant to an executed partnership agreement. *Id.* Accordingly, pursuant to this specific statutory authorization, 100% of the MHRTC may be allocated to Limited Partner even though Limited Partner is entitled to only .01% of all profits because such allocation is pursuant to an executed partnership agreement.^[2]

Ruling 3: IRC § 501(c)(3) Corporate Partners and Transferring the MHRTC Pursuant to G.L. c. 63, § 38R(b)(2)(ii). Corporate partners eligible for the MHRTC may transfer it pursuant to G.L. c. 63, § 38R(b)(2)(ii). That section is, as stated above, worded identically to G.L. c. 62, § 6J(b)(2)(ii) (applicable to c. 62 partners) quoted in Ruling 2 above, except wherever the term "tax" is used in the above-quoted language, § 38R(b)(2)(ii) uses the term "excise." As used in § 38R(b)(2)(ii), "taxpayer" is defined as "a corporation or other entity subject to an excise imposed by [c. 63]." G.L. c. 63, § 38R(a).

Effective January 1, 2006, a new section was added to c. 63 that provides in relevant part that:

[e]very foreign or domestic corporation which is exempt from taxation under section 501 of the Code shall be subject to tax under section 32 or 39 on its unrelated business taxable income, as defined in section 512 of the Code. The property or net worth of the corporation shall not be subject to tax under this chapter and the minimum excise under section 32 or 39 shall not apply. . . . The credits allowed under this chapter shall be determined only with respect to the unrelated business activity of the corporation.

G.L. c. 63, § 38T(a); St. 2005, c. 163, § 28. See *also* St. 2005, c. 163, §§ 19 through 21 and G.L. c. 63, § 30.^[3] With this addition, an IRC § 501(c)(3) corporate partner is, effective January 1, 2006, subject to taxation under c. 63 on any unrelated business income^[4] and thus a "taxpayer" as that term is used in § 38R(b)(2)(ii).^[5] Accordingly, an IRC § 501(c)(3) corporate partner is eligible to transfer the MHRTC, assuming it meets the eligibility requirements set forth in § (7) of the Regulation discussed below, even if, based on the last sentence of § 38T(a), it cannot use the credit itself because it has no unrelated business taxable income or because the MHRTC does not arise from its unrelated business activity. That sentence does not apply to the MHRTC, as its use by a transferee is statutorily not required to be related to the income-producing activity that gave rise to the credit.

"Eligibility requirements" are set forth in § (7) of the Regulation. There it is stated that any taxpayer allowed to take the MHRTC (*i.e.*, any corporation or other entity subject to an excise imposed by c. 63) may transfer it once it has received a final certification on a substantially rehabilitated piece of property and has placed the property in service. 830 CMR 63.38R.1(7); 830 CMR 63.38R.1(2). Accordingly, even though Limited Partner cannot use the credit itself because it has no unrelated business taxable income, it can transfer the MHRTC because Limited Partner is, effective January 1, 2006, subject to taxation under c. 63 on any unrelated business income and thus a "taxpayer"

eligible to transfer the MHRTC pursuant to G.L. c. 63, § 38R(b)(2)(ii). Additionally, the property to which the credit relates has been substantially rehabilitated and placed into service, and a final certification regarding the property has been received from the MHC.

Conclusions

Ruling 1: the Partnership cannot transfer the Massachusetts historic rehabilitation tax credit ("MHRTC") pursuant to G.L. c. 62, § 6J(b)(2)(ii); it may only pass it through to its partners who may then transfer it pursuant to G.L. c. 62, § 6J(b)(2)(ii) or G.L. c. 63, § 38R(b)(2)(ii), whichever applies.

Ruling 2: the Partnership may allocate 100% of the MHRTC to Limited Partner even though Limited Partner is entitled to only .01% of all profits.

Ruling 3: Limited Partner, an IRC § 501(c)(3) organization, is, effective January 1, 2006, subject to taxation under c. 63 on any unrelated business income and thus a "taxpayer" eligible to transfer the MHRTC pursuant to G.L. c. 63, § 38R(b)(2)(ii). An IRC § 501(c)(3) corporate partner may transfer the MHRTC pursuant to § 38R(b)(2)(ii) even if it cannot use the credit itself because it has no unrelated business taxable income or because the MHRTC does not arise from its unrelated business activity. Limited Partner is eligible to transfer the MHRTC because the property to which the credit relates has been substantially rehabilitated and placed into service, and a final certification regarding the property has been received from the MHC.

You submitted an alternative request in the event we ruled that Limited Partner is not eligible to transfer the MHRTC pursuant to G.L. c. 63, § 38R(b)(2)(ii). Because we find that Limited Partner is so eligible, it is unnecessary to consider your alternative request.

Very truly yours

/s/Alan LeBovidge

Alan LeBovidge
Commissioner of Revenue

AL:MTF:pls

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^[1] A similar credit is allowed against the corporate excise imposed by c. 63. In G.L. c. 63, § 38R(b)(2)(i) it is stated that the "[c]redits allowed under this section which are provided to multiple owners of property shall be passed through to the persons designated as partners, members or owners, respectively. . . ."

^[2] The conclusion in Ruling 2 is limited solely to the allocation of the MHRTC. It does not apply to the allocation of any other credit allowed under the Massachusetts General Laws.

^[3] St. 2005 c. 163, §§ 19 and 20 amended § 30 of c. 63 by striking from the definitions of "domestic corporations" and "foreign corporations" language that expressly excluded from those definitions an IRC § 501(c)(3) organization.

^[4] "Unrelated business taxable income" is income from a trade or business regularly carried on by an exempt organization the conduct of which is not substantially related to the organization's exempt purpose. Treas. Reg. §1.513-1(a).

^[5] Whether an IRC § 501(c)(3) corporate partner is a "taxpayer" eligible to transfer the MHRTC allowed under § 38R(b)(2)(ii) prior to January 1, 2006, is not addressed by this letter ruling.

